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Monthly Letter on Economic Conditions Government Finance



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General Business Conditions

THE tense international situation arising out of the Berlin crisis, the mounting wage-price spiral at home, and the action of the President in calling the Congress into extra session for the avowed main purpose of dealing with prices and the housing shortage, have given business men plenty to think about during the past month. Both foreign and domestic possibilities have continued to vie for attention according to the character of the day's news. With war generally recognized as incomparably the greatest disaster that could afflict this country and the world, the apparently more critical turn in the so-called "Battle of Berlin" tended for a time to put everything else in the background. Later, as the tension abroad appeared to ease somewhat, and as the Congress reconvened to consider the President's anti-inflation program, the problem of prices — where they are carrying us and what to do about them — has been thrust forward as a leading subject of concern not only to business men but to the general public as well.

The move by the President in calling Congress coincided with dramatic evidence of the strength of the inflationary forces as wholesale prices, measured by the Bureau of Labor Statistics index, finally pushed through the old World War I high reached in May 1920. While prices of some agricultural products, notably grains and cotton, have fallen substantially from their recent tops under the influence of the fine crops harvested or in prospect, other prices have gone ahead with undiminished vigor. In the food field, prices of hogs and cattle have risen to new peaks on continued high demand and reduced supplies resulting from last year's short corn crop. At the same time, the spreading third round of wage increases since the end of the war has been having its effect, along with other increasing costs, upon prices of a long list of industrial materials and products, including coal, steel, lead, zinc, nickel, some copper products, glass, newsprint, automobiles, and tires. The action of the steel industry, after attempting to "hold the line" on wages and reduced prices, in capitulating to the trend and raising both wages and prices was particularly significant of the powerful upward pressures exerted on prices and costs generally.

With higher prices ruling for most commodities at wholesale, the cost of living index, covering retail prices and rents, continued to move up, reaching in June a figure more than 70 per cent above prewar and, like the wholesale index, a new high record.

The President's Message

The President, in his message to the Congress, rightly stressed the hardships to many people and grave dangers to the country resulting from these inflationary tendencies. Not only are these matters which affect every American family, he declared, but "they also affect the entire world, for world peace depends upon the strength of our economy." Asserting that "if we do not stop inflation, production and employment will both fall

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sharply when the break comes," he warned that this is just the kind of economic collapse the Communists everywhere are counting on.

Although production, the President said, has increased somewhat, "and we want it to increase still more," nevertheless, "even with full employment, full use of available materials and practically full use of plant capacity . . . prices are still climbing faster than production." Hence production, he concludes, is not the only answer. Instead, "we must attack inflation directly."

He then went on to outline an eight-point program of "strong, positive" action, embodying in brief the following:

1. Reestablishment of a corporate excess profits tax.
2. Restoration of controls over consumer credit.
3. Greater authority to the Federal Reserve Board to regulate bank credit.
4. More regulative powers over speculation on the commodity exchanges.
5. Allocation and inventory control of scarce essential commodities.
6. Tightening of rent controls.
7. Authority to reintroduce rationing of scarce essential commodities, if necessary.
8. Restoration of price controls in the case of scarce key commodities affecting industrial production or the cost of living. At the same time the matter of wage controls was approached gingerly, leaving many loopholes. The President continues to talk of "non-inflationary" wage increases. While it is proposed that the Government have authority to limit wage adjustments which would force a break in a price ceiling, such interference would be barred "where wage adjustments are essential to remedy hardship, to correct inequities or to prevent an actual lowering of living standards" — which could just about cover everything.

A Contradictory Program

Having set forth in the first part of his message the foregoing program as "necessary to check high prices and safeguard our economy against the danger of depression," the President then proceeded to devote most of the remainder of his discourse to urging a series of costly proposals that would add to the already huge spending-lending-guaranteeing activities of the Government, and accentuate inflationary pressures.

First on the list was housing. Declaring that we "desperately need more housing at lower prices," the President requested prompt passage of the Taft-Ellender-Wagner bill, with its broad provisions for liberalizing mortgage credit and

guaranteeing yields on housing investment, and for public housing and slum clearance.

There is, of course, no question as to the need for more and cheaper housing. But as the New York Journal of Commerce said editorially on July 28 —

Homes are being erected in this country about as rapidly as is possible with existing supplies of building materials and available labor.

It is estimated that a million new dwelling units will be started this year. This would constitute a new record. It is a remarkable achievement, considering the fact that the capacity of the building industry had been so severely contracted in the depression of the thirties and the war years, and it can be expanded only gradually.

Nothing the Government could do would step up the rate of home construction materially. It is possible through legislation to expand public housing, but this would only contract activity in private construction. The total number of dwelling units would not be changed materially in consequence.

Given these conditions of tightness in the building field, it seems probable that passage of the Taft-Ellender-Wagner bill, or similar legislation, would result, as suggested in these columns a month ago, not in *more* housing but only in *more expensive* housing for most people, with inflationary effects spreading throughout the entire economy. On the latter point, no one has been more emphatic than Mr. Marriner Eccles, of the Board of Governors of the Federal Reserve System and formerly its chairman. Testifying before Congress last Fall, Mr. Eccles described the expansion in "excessively easy mortgage credit for housing" as "perhaps the most inflationary single factor in the present situation."

Again, testifying before Congress last month on the President's recent proposals, Mr. Eccles vigorously opposed as "inflationary" the long-range housing program.

Following housing, the President continued with a whole series of other "musts" for immediate action, including \$300 million a year federal aid to education, upping the minimum wage law in industry from the present 40 cents an hour to "at least" 75 cents, increasing social security old age benefits by "at least" 50 per cent and lowering the retirement age for women from 65 to 60, amending the displaced persons act and ratifying the international wheat agreement, authorizing a government loan of \$65 million for construction of a United Nations headquarters, increased appropriations for public power projects including the \$4 million TVA steam plant, and "equitable and realistic" federal pay adjustments.

Then, "if the Congress finds time," the following should be taken up: a "comprehensive" national health program, repeal of the Taft-Hartley

labor law and substitution of a "fair and sound" labor-management relations act, a "real" long-range farm program, a stronger reciprocal trade agreements act, universal military training, a national science foundation, strengthening anti-trust laws, and, finally, approval of the long-standing and much-debated St. Lawrence waterway project.

Economics vs. Politics

Quite a schedule for an "emergency" session of the Congress! What makes it difficult to understand as an economic program, considering the circumstances of the message, is that most of these projects would involve pouring out more money, or would increase costs directly as in the case of the proposed minimum wage increase. That some of these projects, of and by themselves, have merit is not questioned. But tossing them all into the hopper at a time when, by the President's own testimony, the economy is already dangerously inflated, and, in a message purporting to present an anti-inflationary program, seems explainable only in terms of political considerations.

In effect, what the program amounts to is blowing up the economy with more inflation steam with one hand, and trying to hold the lid on with more controls and more taxes with the other.

As for price controls and rationing of goods deemed in short supply, such proposals evoke memories of the artificial prices and black markets that so exasperated the public until wartime controls were abandoned in 1946 at the people's insistence. Furthermore, price controls and rationing would pose great problems of setting up peacetime enforcement agencies, district offices, regulations and accounting and allocation systems—all adding to the swarm of federal employees and involving businessmen and tradesmen in new miles of red tape.

As regards the corporate excess profits tax—probably the strongest weapon in the President's proposed arsenal—even this may be conceived of as having a two-way influence. While such a tax, if it results in a budgetary surplus that is used to retire public debt held by the banks, tends to exert a deflationary influence upon credit, it also enters into business costs and, like a wage boost, tends to increase prices. To be most effective for anti-inflationary purposes, taxes should bear upon the great mass of spending by individuals. But corporations, of course, do not vote.

A Sound Anti-inflation Program

What, then, would be a sound program for curbing inflation?

First, cut government spending. With our huge \$40 billion budget, the Government today is the biggest spender of all. The President recommends more government spending, whereas what we need is less.

Second, next to government spending, the greatest inflationary factor has been the rapid expansion in urban mortgage credit, fostered by government guarantees on excessively easy terms. We ought to be tightening up on this, instead of pumping out more credit into an already seriously inflated field through more federal subsidies and guarantees for housing construction, now straining at the practical limit of available supplies and labor.

Third, modify price support for agricultural products and let the cost of food come down. It is fantastic that high government officials should be talking about imposing more taxes and more regimentation on the American people while the Government puts a "floor" under wheat at \$2 a bushel on the farm, and spends millions of dollars to keep up the prices of potatoes, eggs, and other foods that might otherwise decline and ease the pressure on the cost of living. Also, lower agricultural prices would reduce the cost of our foreign aid program.

Fourth, before asking for new controls over bank credit, we should be using those which we have—the traditional and tested instruments of the Federal Reserve discount rate and open market operations. As in the case of the agricultural price support policy, it is an anomalous situation to be asking for more powers over credit when we have a discount rate of 1½ per cent, and when money rates generally are set by the banking and fiscal authorities at levels that are an open invitation to inflation.

It is said that we cannot permit interest rates to advance, for then prices of government bonds would decline. The answer to this is that, while some control over interest rates and the government bond market is desirable, this control cannot be carried to the point of absolute inflexibility without making it impossible for credit control to work. While it is true that action in fields other than money is essential to stem inflation, action is needed in money too. We must shut off the spigot on the free and unlimited creation of credit through the simple process of selling government securities to the Reserve Banks at guaranteed minimum prices. Unless interest rates are permitted some flexibility, the Reserve Banks will

have no latitude for exercising their proper discretion in determining the terms and conditions under which their facilities are made available to the market.

Fifth. In addition to what government can do, success in fighting inflation will depend to a large extent on the spirit and good sense of the people. Along with some of the inflationary excesses of today there are many other instances of sound, conservative action. At a time when we have so many examples of inflation and its results, it is not too much to hope that our people can recognize the dangers and act in time to avoid the ills which present trends presage.

The Bumper Crop Outlook

The prospects for cheaper food held out by the Government's July crop report, with its promise of the largest harvest in our history, is a development of the greatest economic significance. Together with the fact that Europe and other food importing areas are having the best crops since hostilities ended, and thus are closer to self-sufficiency, this means that, while politicians wrangle, Nature herself, if we will let her do it, is preparing a basic remedy for the inflationary wage-price spiral. Since food is the most important component of the cost of living index, a reversal of the upward trend of food prices could be expected to cut much of the ground from under pressure for a fourth round of wage increases next year.

The influence of larger crops will not show up in lower food prices right away. For considerable time will be required to transform a bumper corn crop harvested in the fall, into increasing supplies of meat, dairy and poultry products. It is in this area that the food price inflation has been greatest and where the increased production will bring about the most price relief. Just as the full effects of last year's short corn crop only now are showing up in record high prices for meats, poultry, and dairy products, so the adjustment back to lower price levels can hardly be felt until next year. But the prospect for record feed grain crops is providing a firm foundation upon which to rebuild our livestock numbers, which still are declining in the aftermath of last year's corn crop failure.

Equally significant in its implications for an easing in food prices is the favorable crop prospect in Europe and North Africa, where Nature also is smiling this year. In sharp contrast to last year's crop failure, the European bread grain, potato and sugar beet crops this year are approaching prewar levels for the first time. Early in July, the European wheat crop ex-Russia was

expected to reach 1,450,000,000 bushels, a 35 per cent increase over last year, and only 13 per cent short of the prewar average. This should soon be reflected in some easing up in the extremely heavy export demands made these past three seasons on the surplus food producing countries which in turn can begin to retain more of their own food production for home consumption at lower prices.

The Record Corn Crop

The corn crop holds the key to lower food prices. The July 1 estimate of 3,329 million bushels, the largest on record, indicates that there may be at least 900 million bushels more corn for feeding livestock next season. Although corn acreage this year, with one exception, is the smallest in over 50 years, an important factor in the bumper corn prospect is the fact that about 75 per cent of the crop was planted to high yielding hybrid varieties. Also sharing credit for the gain of 2 bushels per acre over the previous record is the use of more fertilizer, more power machinery for timely cultivation, and extensive use of chemicals for weed control. Iowa, the largest corn producing state, has one of the best stands in its history. All through the Corn Belt the crop has been making exceptionally rapid progress this year, with all indications pointing to an unusually early harvest, which practically eliminates any danger from frost damage. The early feed grain crops, oats and barley, already are in full harvest and together are about 250 million bushels larger than last year.

The country thus is on the verge of a significant transition from a feed grain shortage back to a feed grain surplus, with a heavy movement into farm reserves and the government loan clearly indicated. The record feed grain crops find our grain consuming animal numbers cut back to below prewar levels and near an all-time low on a per capita basis. The result is that even after allowance for the low level of our feed grain reserves and the probability of a heavy export movement to Europe next season, the available supply of feed grains per animal unit will be 25 per cent larger than this season and much the largest on record.

Reflecting this drastic change, new crop corn already is adjusting to a sharply lower price level. Old crop corn, which has held in a price range of \$2.30 to \$2.40 bu. in Chicago most of this season, still is selling around \$2.00. But in the futures market, corn for December delivery is selling below \$1.50, which is over 10c below the probable floor to be provided by the government loan.

The Livestock and Meat Situation

With livestock prices expected to remain at a relatively high level through most of next winter, and feeding costs soon to be lowered, producers will be given an incentive to feed animals to heavy slaughter weights, as well as to hold back breeding stock for increased livestock numbers next year. When cattle come off the ranges this fall, a heavy movement into the feed lots is to be expected, which will mean a much larger supply of the better grades of beef next summer. Right now, beef is in particularly short seasonal supply because of the vacuum created by the 25 per cent decline in feeder cattle going into the feed lots last winter.

While the full effects of the short corn crop on beef supplies only now is being felt, the milk and poultry industries have felt its influence for some time as high feed costs have forced heavy culling of dairy cows and poultry flocks. Record high prices now being paid by consumers for milk, chickens and eggs have not proved profitable for producers, squeezed by still higher costs, and the output of these important protective foods has continued downward all year. In June, egg production had reached the lowest level for the month since 1942. After allowance for our fast-growing infant population, milk production in June actually was the lowest in the 19 years of record, barring the drought year of 1934.

The greatest rise in food prices this year has been in dairy products. It is significant that the liquidation of dairy cows has been greater than in beef cattle. Dairying is a seven-day week industry. Wholly aside from the feed shortage, costs have mounted sharply as the dairy industry competed for a labor supply against other less arduous agricultural pursuits as well as with the industries where the trend is toward the more attractive 5-day week.

First improvement in meat supplies is expected to come from broiler chicken production. In itself, this will not add as much to total meat supplies as will the heavier marketing weights of hogs and cattle to be expected from next winter's slaughter. However, the first really large increase in meat supplies sufficient to bring price relief, other than from seasonal factors, probably must await the expected large increase in next spring's pig crop. These hogs will not come to market in the form of pork products until the fall of 1949.

Wheat Prices Go Below Loan Levels

The almost miraculous recovery of the winter wheat crop from its extremely poor start last fall has resulted in a July estimate for a total wheat crop of 1,242,000,000 bushels, second only to last

year's all-time record. The winter wheat harvest is now over and spring wheat harvesting is about at its peak. With our carryover stocks at 195 million bushels on July 1, more than twice as large as a year ago, the total wheat supply is equally as large as last season. The exportable surplus is actually the largest on record.

The increase in our wheat reserves in the face of a short corn crop is a tribute to the free price mechanism which successfully kept down the feeding of wheat to livestock and permitted record exports of 485 million bushels to a hungry world, nearly as much as was processed by our own domestic flour industry. This is in sharp contrast to our experience two seasons ago when, despite a large corn crop, price ceilings kept wheat too cheap in relation to feed grains and precipitated a flour and bread shortage in the spring of 1946, after too much wheat had been fed to animals earlier in the season.

Faced with a crop in excess of domestic and export requirements, wheat already has sold down below the government support level in most markets, and a heavy movement into the loan is generally expected. The 1948 wheat loan is \$2.00 on the farm and \$2.29 in Chicago. A crop of the size now indicated should provide a surplus more than adequate to meet any foreseeable export needs. Only a really short Canadian crop, which for a time suffered some damage from dry weather, seems likely to keep our wheat reserves from rising still higher by next summer.

Farm Price Supports

In appraising the prospect for lower food prices in the face of the bumper crop outlook, sight must not be lost of the Government's policy of supporting farm prices. Mention already has been made of the expected heavy movement of wheat and feed grains into the loans this year. Just recently, the Government has announced an added support to grain prices through a purchase program whereby farmers may secure an option to deliver grains to the Government at the loan level anytime up to the end of next May. This eliminates the red tape of loan applications and the need of placing wheat in storage positions eligible for loans, but at the same time gives the farmer an incentive for withholding his wheat for higher prices, without incurring any risk should prices go lower.

Government policy also is working against a lowering of the cost of living in other directions. The Secretary of Agriculture cut the sugar quotas twice by a total of 800,000 tons, and the resulting artificial tightening of supplies has caused a rise in the price of refined sugar. Late last month,

quotas were raised by 200,000 tons in response to widespread criticism from sugar consuming industries. Through purchase and loan operations the Government is engaged at the present time in pegging prices of eggs and potatoes, which otherwise would be seeking lower levels to equate supplies with demand. It purchased the dried fruit surplus from last year's crops, most of which was shipped to occupied areas, and is now negotiating to take over the coming surplus from the 1948 crops. During the past year the Government has entered the markets and held up prices of quite a number of diversified farm commodities including peanuts, turkeys, grapefruit juice, honey, tobacco, wool, flaxseed, rosin, turpentine, linseed oil, and tung oil. It is now recommending that farmers reduce their winter wheat acreage 8 per cent for the 1949 crop, obviously with the intent of avoiding the accumulation of embarrassing surpluses at the support price. It is these actions which prompted Representative Buck of New York to remark during the debate in Congress preceding the recent extension of farm price support until the summer of 1950, that the title of the bill should have been "A bill to guarantee that the high cost of living will not go down for two years and for no other purpose."

Credit Developments

The past month has witnessed a continuation of the heavy demand for long-term capital that characterized last year and the first half of this year. Demands for funds to finance business expansion, and postwar projects being launched by State and local governments, are exceeding the pace of 1947, and the same appears to be true of the expansion in mortgage credit. The United States Treasury entered the market the first part of July with a special offering of Series F and G Savings bonds to institutional investors which resulted in a sales total of just over \$1 billion.

The accompanying summary, drawn from the tabulations of the Commercial and Financial Chronicle, compares the volume of securities issued for purposes of raising new capital in the

first six months of 1948 and the first halves of 1946 and 1947.

As the table indicates, all issues for new capital tabulated by the Chronicle have run 40 per cent ahead of 1947 and three times the rate of 1946. The two biggest items this year are the demands by State and local governments, and by public utilities, each of which was already well past the billion dollar mark in the first six months of the year. Also noteworthy are the sharp relative increases in new capital requirements of oil companies and railroads. When demands for home financing are tacked on, the conclusion is inescapable, as was suggested in these pages last November, that demands for capital are tending to run well beyond the rate at which new savings are accumulating for long-term investment.

Save for temporary financing of new security issues during their periods of distribution, and sizable purchases of shorter term obligations offered by State and local governments, the commercial banks played a relatively minor role in financing capital outlays during the first half of 1948. The bulk of the new money raised was provided by insurance companies, mutual savings banks, savings and loan associations, which supplemented their resources available for new undertakings by selling government securities to the Federal Reserve Banks.

The measures of credit restraint of the past winter clearly had an important influence in holding down the bank loan totals. This is evident not only in the figures on business loans, which are lower than they were at the year-end, but also in a slackened rate of increase in bank loans on real estate. Some rise in business loans is to be expected during the second half of the year as the crops are moved and as other seasonal influences come into play. The recent price and wage advances have increased business requirements for working capital which would normally require some increase in bank loans.

The special offering by the Treasury of Series F and G Savings bonds to institutional investors was open during the period July 1-15. Insurance companies, mutual savings banks and other specified types of institutional investors were allowed to make purchases up to a limit of \$1,000,000, and commercial banks holding savings deposits to a limit of \$100,000. Money realized from the special offering is being used to retire Treasury bills held by the Federal Reserve Banks, at a rate of \$100 million a week, offsetting some of the inflationary effect of the Federal Reserve's purchases of government securities in the open market.

New Security Issues for Purposes of Raising New Capital
(In Millions of Dollars)

	First Six Months		
	1946	1947	1948
Corporate			
Railroads	258	108	20
Public utilities	1,417	686	90
Industrial and manufacturing	622	688	634
Oil	391	127	82
Other corporate	349	260	279
Total corporate	3,037	1,869	1,105
Federal agencies	192	97	78
State and municipal	1,582	1,327	454
Foreign governments	—	118	—
U. S. possessions	4	23	—
Grand Total	4,815	3,419	1,632

Source: Commercial and Financial Chronicle.

Continuance of "Easy Money"

Despite the weight of the aggregate demands for funds, which threaten to smash all previous peace-time records, no clear tendencies were evident for lenders to "run out of money" or even for money rates to tighten up. For this, the explanation lay simply in the Federal Reserve Banks' intervention in the market to keep government bond prices from falling and interest rates from rising. Yields on government securities provide the pivot of the entire interest rate structure and, so long as the Federal Reserve Banks provide supports at par or above, holders can turn their government securities into cash on advantageous terms and use the proceeds to meet demands for funds. The pressure on lending institutions to do so was increased by the Treasury's decision last spring to keep the rate it pays for one-year money at 1½ per cent.

New Rise in Federal Reserve Portfolio

When markets are so thoroughly "managed", the amounts bought and sold by the managers, rather than price fluctuations, provide the key to the shifting balances of buying and selling pressures. As the following simplified analysis of the Federal Reserve open market portfolio shows, the Reserve Banks, during the last five weeks, have purchased some \$380 million long-term bonds and \$220 million of various classes of short-terms in the open market in support of market prices. With the benefit of \$400 million redemptions of Treasury bills, the total Federal Reserve portfolio has increased \$200 million, net, over the five weeks.

Federal Reserve Operations in Government Security Market
(In Millions of Dollars)

	Dec. 31, 1947 to March 24, 1948	March 24 to June 23	June 23 to July 28
Market transactions in —			
Bonds over 5 years to maturity	+2,643	— 46	+380
Bills, certificates, notes and shorter term bonds	—1,027	+836	+220
Redemptions by Treasury	—3,568	—387	—400
Net change in portfolio	—1,952	+403	+200

It is now possible to see three definite phases of Federal Reserve open market operations this year. In the first twelve weeks of the year, through March 24, the Reserve Banks purchased over \$2½ billion long-terms in price support operations. Nevertheless, with the benefit of redemptions from the Treasury surplus and the increased market demand for short-terms, they were able to cut down their total portfolio substantially.

In the second phase — from March 24 to June 23 — support of the long-term market was not needed but the Federal Reserve Banks took on

over \$800 million short-terms. Some of these came from holders disappointed with the continuance of the 1½ per cent one year rate; others came from the New York and Chicago banks raising cash to meet the ordered increase in their reserve requirement percentages. Only about half of this \$800 million was offset by Treasury redemptions of Federal Reserve-held government securities; only nominal amounts of long-terms were sold; and the upshot was a \$400 million growth in the total portfolio. The third phase — since June 23 — has been one of supporting both the long and the short ends of the market and a further increase in the total portfolio.

The record seems to bear out the reasoning of those who, last spring, had advocated letting rates rise another notch and easing back official support levels. There is no question but that an expansionary drift in the Federal Reserve portfolio feeds inflation. Money has to be made harder to get — from lending institutions and the national Treasury — before we can hope to defeat the rising trend of prices. The path to the Federal Reserve Banks, for more money, is too easy.

When the credit authorities will act again, and what the line of attack will be, are questions that many observers are asking. The longer effective action is delayed, along this and other anti-inflation fronts, the more vigorous action will have to be to do its job, and the greater the disturbances to employment, trade and industry.

The Half Year's Earnings

Reports issued during the past month by leading manufacturing corporations show that in most industries the dollar volume of sales in the first half year rose to a new peacetime high, with the total about 19 per cent above the first half of 1947, and 7 per cent above the second half. Some of this increase represented the gain in physical production generally, and particularly in the automobile and other durable goods industries where output is still expanding to meet the tremendous accumulated demand, but the major portion reflected merely the advances that have occurred in prices.

Net earnings after taxes also increased, both in the aggregate and in the case of most reporting companies, and net profit margins per sales dollar continued around the generally high level established in the last quarter of 1946. With some individual companies, however, there were considerable changes in profit margins, due to the fluctuations in total revenues and to the widely varying impact of labor, material, and other costs. While some producers were squeezed

this year by rising costs, others recovered from a 1947 squeeze through better control of expenses, larger volume, or higher selling prices.

Our tabulation of the reports of 525 companies issued to date, which comprises mainly the larger manufacturing organizations but includes also a number of companies in the mining, retail and wholesale trade, service and amusement fields, shows for the first half year a combined net income after taxes of approximately \$2,288 million, which compares with \$1,781 million in the first half of 1947, and \$1,931 million in the second half. The increase over the first half year was 28 per cent, and over the second half 18 per cent. Despite these increases in the totals, about two out of five reporting companies had a decrease as compared with 1947.

Upon the net worth, made up of capital stock and surplus accounts taken at book value and aggregating \$24.3 billion at the beginning of 1948, the half year's earnings were at an annual rate of 18.8 per cent, compared with a 1947 net worth of \$21.8 billion and a return of 16.3 per cent in the first half year and 17.7 in the second. The accompanying summary gives the comparative figures by major industrial groups.

It will be seen that most of the industrial groups showed increases in net income over 1947, particularly over the first half year. The largest increase was in the petroleum refining group, where the net income of 23 reporting companies increased by 80 per cent over the first half of last year, reflecting the expansion to new record

levels in sales of gasoline, fuel oil, and other petroleum products, and also the increases in selling prices. Whereas the combined total for the 525 companies was up 28 per cent from a year ago, the total for 502 excluding the important petroleum group was up only 13 per cent.

Another group showing an outstanding gain was that comprising 12 manufacturers of automobiles and trucks, whose net income was 51 per cent above that of the first half of 1947, accompanying a 30 per cent expansion in dollar volume of sales.

A group of 32 iron and steel companies, operating at virtual capacity, had an increase of 16 per cent in their dollar sales but, because of rising costs, an increase of but 4 per cent in net income. Net profit margin was narrowed slightly, from an average of about 6.9 cents per sales dollar in the first half of 1947, to 6.1 cents this year.

Although the steel companies recently increased their selling prices to compensate for the increases granted in wages and for higher costs of fuel, scrap, and other supplies, the rise in steel prices since prewar has lagged well behind the rise of prices generally. Even after the markup just put into effect, the composite price of steel products computed by the Iron Age as of July 27 shows an increase over 1939 of 63 per cent, in contrast with an increase of 118 per cent in the B.L.S. general index of wholesale prices.

The mining and quarrying group of 41 companies includes producers (but not refiners) of crude oil, which had a sharp increase in earn-

NET INCOME OF LEADING CORPORATIONS FOR THE FIRST HALF YEAR
Net income is Shown as Reported — After Depreciation, Interest, Taxes and Other Charges and Reserves, but Before Dividends. Net Worth Includes Book Value of Outstanding Preferred and Common Stock and Surplus Account at Beginning of Each Year.
(In Thousands of Dollars)

No. of Cos.	Industrial groups	Net Income			Net Worth		Annual Rate of Return %		
		1st Half 1947	2nd Half 1947	1st Half 1948	January 1 1947	January 1 1948	1st Half 1947	2nd Half 1947	1st Half 1948
30	Food products	\$ 129,190	\$ 113,342	\$ 116,898	\$ 1,108,444	\$ 1,227,255	23.4	20.5	19.0
11	Beverages	45,705	51,449	40,654	389,993	446,434	24.0	27.1	18.2
32	Textiles and apparel	45,268	49,047	55,209	378,882	455,503	23.9	25.9	24.2
25	Pulp and paper products	32,292	50,618	54,758	427,596	513,950	24.5	23.7	21.3
34	Chemicals and paints	169,225	163,038	186,046	1,971,232	2,248,641	17.2	16.5	16.5
9	Drugs, soap, cosmetics	22,213	20,960	18,260	202,466	219,292	21.9	20.7	16.7
23	Petroleum products	414,409	511,104	745,789	5,750,757	6,447,801	14.4	17.3	23.1
21	Cement, glass and stone	45,459	43,298	48,653	506,926	557,798	17.9	17.1	17.4
32	Iron and steel	215,278	192,272	224,522	3,630,245	3,859,643	11.9	10.6	11.6
15	Electrical equipment and radio	86,843	105,818	104,967	928,590	1,042,655	18.7	22.8	20.1
41	Machinery	42,849	89,410	43,752	472,990	518,518	18.1	16.7	16.9
12	Autos and trucks	162,029	202,918	244,926	1,728,828	1,942,875	18.7	23.5	25.1
22	Automobile parts	31,226	34,876	35,650	276,812	321,629	22.6	25.2	22.2
93	Other metal products	130,072	138,293	147,176	1,562,846	1,746,191	16.6	17.7	16.9
40	Miscellaneous manufacturing	65,284	64,241	63,828	749,536	815,585	17.4	17.1	15.7
440	Total manufacturing	1,657,842	1,780,674	2,130,183	20,971,183	22,263,770	16.5	17.7	19.1
41	Mining and quarrying	69,685*	90,195*	108,027*	902,095	1,007,697	15.4	20.0	21.4
25	Trade (wholesale and retail)	35,227	43,270	34,986	824,510	964,160	13.4	16.5	12.4
19	Service and amusement	18,823	17,051	14,551	347,048	353,480	10.6	9.8	8.1
525	Total	\$1,780,577	\$1,931,190	\$2,287,747	\$21,844,936	\$24,294,107	16.3	17.7	18.8

* Before depletion charges in some cases.

ings, as well as coal and metal mining companies, many of which benefitted from the heavy output and higher prices.

In the service and amusement group, motion picture companies experienced a cut in earnings this year as a result of smaller theatre revenues and curtailed remittances from foreign subsidiaries. Retail and wholesale trade organizations have been under pressure in both 1947 and 1948 by rising costs, increasing competition, and mark-downs needed to clear out slow-moving inventories. Some of the baking companies whose 1947 earnings were squeezed by the rise in flour prices made a recovery this year, while at the same time numerous companies in other food lines whose 1947 earnings were swelled by non-recurring inventory profits show a decline.

The longer-term trend of earnings, as measured by rate of return on net worth and profit margin on sales, is given in the chart at the bottom of the page.

Preliminary figures for the second 1948 quarter show a slight increase over the first 1948 quarter in both sales and net income, indicating that the return on net worth and profit margin on sales both continue at around the levels reached in the latter part of 1946. The relative stability of these overall averages, as pointed out earlier, does not reflect the marked shifts continually taking place among individual companies, and may not be representative of large numbers of small and closely-held manufacturing concerns which do not issue public reports.

Corporation executives, when presenting their statements of current earnings, have emphasized the continuing problems of financing substantial outlays for modernizing and expanding plant and equipment, and of making provision for the future replacement of fixed assets which are carried on their books at original costs, less depreciation, which are far below present-day costs.

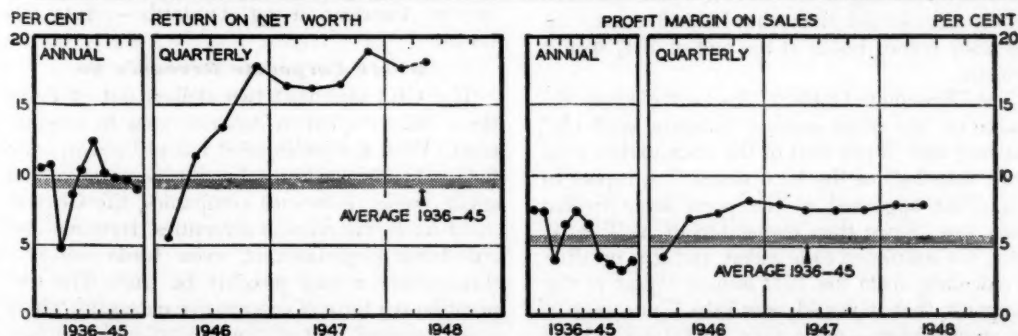
Leading electric utility systems had gross revenues in the first half year about 11 per cent higher than in the corresponding period of 1947, but net income was 5 per cent lower, owing to the rise in operating expenses. Fuel costs were up 37 per cent, and wages 14 per cent.

Railroad traffic during the first half year was affected adversely by the severe winter weather and spring floods, and by the coal strike. The volume of freight handled was slightly less than a year ago, but freight revenues were higher because of the rate increases. Passenger business was lower both in amount and in revenues, despite the increase in fares. Total revenues were up about 11 per cent, but total expenses, taxes, and other charges increased by about the same amount, so that net income for all class 1 railroads as a group was little changed from 1947, even though certain individual railroads made a much better showing.

Who Owns Corporations?

The July issue of the "Economic Outlook," published by the Congress of Industrial Organizations, devotes itself to the topic, "Who Owns Corporations?" The CIO draws a picture of a relatively small group of people, by "direct ownership and various control devices," deciding "the basic economic policy of America . . . how many factories shall be built, how much corporations should save and what wage increases should or should not be granted."

Less than six million people, the CIO says, own stock in corporations. "Most of the stockholders own only a few shares" and "the handful who own the large blocks of stock have complete control." Referring to corporation advertisements and radio speeches which tell how many thousands of people from all walks of life own stock in corporations, the CIO cites the pride of the American Telephone and Telegraph Com-



Average Annual Rate of Return on Net Worth, and Average Net Profit Margin on Sales, of Leading Manufacturing Corporations. (Quarterly figures for 1946-48 based upon 400 manufacturing corporations, with second quarter of 1948 partly estimated. Annual figures for 1936-45 based upon our tabulations of annual reports covering a much larger number of manufacturing corporations.)

pany in the breadth of the ownership of its stock, the average holding amounting to about thirty shares. "They forget to say," comments the CIO accusingly:

that each of the thirty largest stockholders owns an average of more than 35,000 shares. Quite a difference between 30 shares and 35,000. The latest over-all estimate available shows that 5 per cent of the stockholders own more than half of the total shares.

The average holders of thirty shares are referred to, ironically, as "thrifty little people" — "widows, orphans and nice old folks." The implication is that the thirty largest stockholders, with an average of 35,000 shares each, govern the affairs of the vast enterprise and monopolize the earnings.

The "Handful" in Control of the A. T. & T.

As the CIO says, there is "quite a difference between 30 shares and 35,000 shares." Differences in individual shareholdings represent differences in resources, differences in the will to save, differences in investment policy. Such differences are inevitable where the individual has freedom and opportunity.

There is, consequently, room to question whether the ratio of 35,000 to 30 has any ulterior significance. As a matter of fact, the 35,000 shareholding is a kind of fiction if the CIO is thinking about individual holdings. The five very largest stockholdings in the telephone company, and a majority of the thirty largest, are not held by individuals but by nominees of trust companies. Stock registered in the names of these nominees is held for the beneficial interest of many thousands of individuals. They get the dividends and also may have an independent voice in determining how stock held for their benefit shall be voted. Others of the very largest holders are typically brokerage firms, insurance companies, and investment trusts. Here again the stock is held for the benefit of numerous individuals. Thus, if we consider all these beneficial interests, the real ownership of the A. T. & T. is even more widely distributed than the 723,000 names on the stock record books at the end of 1947 would indicate.

The "Economic Outlook" does not disclose the source of "the latest over-all estimate available" showing that "5 per cent of the stockholders own more than half of the total shares." A report to this effect appeared in the press some twelve years ago. Since then ownership of A. T. & T. stock has continued to broaden, and it is possible to calculate, from the 1947 annual report of the company, that it would now take 7 per cent of the stockholders — more than 50,000 accounts — to command a majority of the voting power and dividends. Fifty thousand is quite a "handful".

It is six times the combined membership of all the 48 State legislatures.

The Real Issue

The CIO might have made out at least a superficially better case if it had taken a major corporation whose ownership is far less widely dispersed. The Ford Motor Company, for example, has been substantially under the control of one man or one single family ever since its founding in 1903. But, the question may be asked, what of it? Is not the really important question, who have benefitted from the operations of the Ford Company? Who have owned the millions of motor cars produced by the Ford Company? Certainly not the Ford family alone!

Everyone knows that Henry Ford's achievement was in putting prices down within reach of the average citizen, while paying wages higher than those generally current in industry, and using the major share of profits to add to plant and to buy tools and equipment to make still more cars.

As has been stated before in this Letter,

That a business owned by thousands of shareholders must be directed and managed by a relatively small number, is necessarily true, but "control" in this sense may not mean what is often assumed of it. It certainly does not mean that the earnings of the business do not belong to all the shareholders or that the latter will not receive them. Nor does it mean that in the future there will be no opportunities for individuals of initiative and business capacity, or that all of the business of the country will be done by large corporations.

However, instead of an argument, the best answer to such problems is to be had from the facts of past experience. What finally becomes of the products of the economic system? How many share in them and how? Where do they disappear? Is it true that the tendency to closer cooperation, larger corporations and a wider distribution of ownership, tends either to lessen the volume of production or to concentrate the benefits of the system in the hands of a few?

The answer to the last question is clearly, no. The facts of past experience — the whole history of the development of American industry and rise in American living standards — refute this thesis.

Where Corporate Revenues Go

The CIO says that two dollars out of every three dollars spent in America goes to corporations. With the widespread use of the corporate form of organization — by business large and small, banks, insurance companies, the Government itself, churches, universities, fraternal and charitable organizations, even trade unions — this statement may possibly be true. The corporation is a form of cooperative enterprise which is an essential part of the institutional structure of modern-day society. If corporations receive two dollars out of every three they also spend

around two dollars out of every three and it also follows that a good part of the money spent is passed from one corporation to another—for example, as merchants pay their bills for goods and freight charges.

What the CIO evidently wants to imply is that there is something nefarious about the distribution of the money business corporations take in. For an answer to this we have only to look at the Department of Commerce compilations on the disposal of income originating in corporate business. The following analysis is drawn from their data for 1947, which have just become available:

Disposal of Income Originating in Corporate Business

	1947 Billions of Dollars	Percentage Distribution
Compensation of employees	82.0	73.1
Federal and State income tax	11.7	10.4
Dividends	6.6	5.9
Interest	1.1	1.0
Profits plowed back into business	10.8	9.6
Total income originating in corporate business*	112.2	100.0

* Before "inventory valuation adjustment."

Source of dollar figures: Department of Commerce, Survey of Current Business, July, 1948.

Dividends received by the owners came to \$6½ billion or 6 per cent of the total income originating in corporate business. The income tax collector took more than half again as much, 10 per cent. Plowed back profits came to 9½ per cent. The lion's share went to employees, compensation of whom aggregated \$82 billion, 73 per cent of the total.

If, as the CIO claims, "a relatively small group of people" decide "what wage increases should or should not be granted," and all the rest, it is indeed interesting that such a relatively small part of the income should be taken by the owners while the highest wages ever known in this or any other country are paid to the working man. How much larger share of the pie does the CIO think ought to be paid to employees?

The Mystical "They"

The myth of the mystical "they"—who decide everything—is an old bugaboo that is repeatedly resurrected to scare people. The CIO itself is well aware that there are two sides to the bargaining table in wage negotiations. The consumer is well aware of his power of choice between competing products. The employer is well aware of the necessity of meeting the competition of other employers for labor as well as of maintaining a price that will command a broad market. Pretty nearly everyone knows how often the Government puts in an oar on wage negotiations.

As the figures show, the rewards for taking business risks—which dividends represent—are a moderate proportion of the revenues of corpo-

rations. These dividends in turn go to millions of holders. Anyone can get himself on the stock registration books who is willing to take a risk with his money, and anyone can adjust his holdings up or down within the limits of his resources and willingness to abstain from present consumption for a future gain. The secret of the larger individual stockholdings lies in successful risk-taking. And whether the individual wins or loses, the society as a whole gains from the capital he has provided and the competition he has injected. The same cannot be said of the State lotteries, which in Russia and elsewhere serve as an outlet for the irrepressible yearnings of men to advance themselves beyond their neighbors.

The picture that the CIO draws—of autocratic monopoly crushing down the worker and snuffing out the small business man—is one that cannot be reconciled with the 31,000,000 passenger cars on the road, the 36,500,000 telephones in service, the 68,000,000 radios, and the electrical appliances and gadgets beyond all count in the home. In many other lands these things, plus innumerable other conveniences and luxuries that the average American takes for granted, are reserved to the few. Nor can the CIO theory that the small business man is "disappearing" be reconciled with the reports of the Department of Commerce that the number of businesses in operation has hit a new peak for all time of 3,848,000.

The shoe fits much better on a thoroughly "planned," socialized, or communized economy. There the fact of concentrated authority, in "a relatively small group of people," is beyond cavil. Whether the public gains or loses by such socialization depends of course on the degree of progressiveness and efficiency with which the industries are run. If soundly run, even socialized industries must withhold some portion of the earnings from distribution for renewal and expansion of plant to keep up with increasing demands. The small percentage of the profits which shareholders under private enterprise take for their own personal use, and do not plow back by way of reinvestment in enlarging the capacity of the industries, seems a small price to pay for the dynamic quality inherent in the capitalistic system.

As for monopoly power, that which has been brought most forcibly to the attention of the American people in recent years is not one held by any group of business leaders. Rather it is the power held by the leadership of the coal miners to close the mines, turn off the nation's fuel supply, and stall the whole machinery of our civilization.

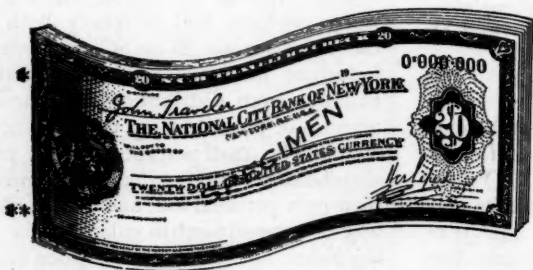


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